

AUDITED FINANCIAL STATEMENTS

St. Joseph Health Services of Rhode Island  
Years Ended September 30, 2008 and 2007  
With Report of Independent Auditors

**St. Joseph Health Services of Rhode Island**

**Audited Financial Statements**

**Years Ended September 30, 2008 and 2007**

**Contents**

|  |   |
|--|---|
| Report of Independent Auditors .....                     | 1 |
| Audited Financial Statements                             |   |
| Statements of Financial Position.....                    | 2 |
| Statements of Operations and Changes in Net Assets ..... | 3 |
| Statements of Cash Flows .....                           | 5 |
| Notes to Financial Statements .....                      | 6 |

## Report of Independent Auditors

Board of Trustees  
St. Joseph Health Services of Rhode Island

We have audited the statements of financial position of St. Joseph Health Services of Rhode Island (the Corporation) as of September 30, 2008 and 2007, and the related statements of operations and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Corporation's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of St. Joseph Health Services of Rhode Island at September 30, 2008 and 2007, and the results of its operations and changes in net assets, and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 2 to the accompanying consolidated financial statements, in 2007 the Corporation changed its method of accounting for its defined benefit pension plan.

*Ernst & Young LLP*

February 23, 2009

# St. Joseph Health Services of Rhode Island

## Statements of Financial Position

|  |    | September 30         |                       | September 30 |                      |
|--|----|----------------------|-----------------------|--------------|----------------------|
|  |    | 2008                 | 2007                  | 2008         | 2007                 |
| <b>Assets</b>  |    |                      |                       |              |                      |
| <b>Current assets:</b>   |    |                      |                       |              |                      |
| Cash and cash equivalents  | \$ | 5,803,053            | \$ 8,759,436          | \$           | 8,548,370            |
| Investments  |    | 8,230,973            | 13,493,661            |              | 213,255              |
| Patient accounts receivable, less reserves of \$9,073,213 in 2008 and \$7,434,447 in 2007 for estimated uncollectible accounts |    | 21,484,540           | 25,787,427            |              | 7,616,301            |
| Other receivables  |    | 1,289,567            | 1,699,706             |              | 8,201,412            |
| Inventories  |    | 2,318,884            | 2,425,216             |              | 578,093              |
| Current portion of assets held by trustees under loan indenture  |    | 1,073,374            | 1,024,627             |              | 1,485,754            |
| Current portion of pledges receivable, net   |    | 89,623               | 77,504                |              | 8,201,412            |
| Prepaid expenses   |    | 1,261,837            | 541,889               |              | 578,093              |
| <b>Total current assets</b>  |    | <b>41,551,851</b>    | <b>53,809,466</b>     |              | <b>1,501,857</b>     |
| <b>Assets whose use is limited:</b>  |    |                      |                       |              |                      |
| Held by trustees under loan indenture  |    | 1,584,582            | 1,626,990             |              | 26,643,185           |
| Beneficial interest in perpetual trust   |    | 5,516,026            | 6,713,613             |              | 32,622,747           |
| Held by trustee under workers' compensation program  |    | 1,082,530            | 779,905               |              | 3,414,516            |
| Endowment funds  |    | 1,168,715            | 1,122,066             |              | 29,345,602           |
|  |    | <b>9,351,853</b>     | <b>10,242,574</b>     |              | <b>3,414,516</b>     |
| <b>Liabilities and net assets</b>  |    |                      |                       |              |                      |
| <b>Current liabilities:</b>  |    |                      |                       |              |                      |
| Accounts payable   |    |                      |                       |              | 2,940,119            |
| Deferred revenue   |    |                      |                       |              | 10,300,802           |
| Accrued expenses   |    |                      |                       |              | 3,968,249            |
| Estimated settlements due to third-party payors  |    |                      |                       |              | 2,875,158            |
| Current installments of long-term debt   |    |                      |                       |              | 19,408,021           |
| Current obligations under capital leases   |    |                      |                       |              | 19,523,133           |
| <b>Total current liabilities</b>   |    |                      |                       |              | <b>85,654,731</b>    |
| Insurance reserves   |    |                      |                       |              | 73,536,547           |
| Pension liability  |    |                      |                       |              |                      |
| Capital lease obligations  |    |                      |                       |              |                      |
| Asset retirement obligation  |    |                      |                       |              |                      |
| Long-term debt, excluding current installments   |    |                      |                       |              |                      |
| <b>Total liabilities</b>   |    |                      |                       |              |                      |
| <b>Net assets:</b>   |    |                      |                       |              |                      |
| Unrestricted   |    | 376,848              | 397,536               |              | 1,429,936            |
| Temporarily restricted   |    | 44,868,564           | 48,170,734            |              | 2,823,810            |
| Permanently restricted   |    | —                    | 86,810                |              | 6,636,799            |
| <b>Total net assets</b>  |    | <b>396,160</b>       | <b>408,787</b>        |              | <b>10,890,545</b>    |
| <b>Total liabilities and net assets</b>  |    | <b>\$ 96,545,276</b> | <b>\$ 113,115,907</b> |              | <b>\$ 96,545,276</b> |

See accompanying notes.

St. Joseph Health Services of Rhode Island

Statements of Operations and Changes in Net Assets

|  | <b>Years Ended September 30</b> |                |
|--|---------------------------------|----------------|
|  | <b>2008</b>                     | <b>2007</b>    |
| Unrestricted revenues, gains and other support:                                      |                                 |                |
| Net patient service revenue  | \$ 173,233,027                  | \$ 172,251,756 |
| Other operating revenue  | 7,154,448                       | 6,240,416      |
| Net assets released from restriction   | 281,930                         | 180,842        |
| Total revenues, gains and other support  | 180,669,405                     | 178,673,014    |
| Operating expenses:  |                                 |                |
| Salaries and benefits  | 108,380,680                     | 106,738,102    |
| Supplies and services  | 55,655,207                      | 53,336,452     |
| Licensing fee  | 5,259,352                       | 4,919,485      |
| Interest   | 1,407,216                       | 1,467,557      |
| Depreciation and amortization  | 6,073,434                       | 5,473,206      |
| Provision for bad debts  | 13,134,259                      | 9,140,374      |
| Total operating expenses   | 189,910,148                     | 181,075,176    |
| Deficiency of revenues over expenses   | (9,240,743)                     | (2,402,162)    |
| Change in unrealized gains on investments  | 9,486                           | 68,631         |
| Adjustment to pension liability  | (18,970,104)                    | —              |
| Cumulative effect of change in accounting principle<br>for adoption of FAS 158       | —                               | (4,572,794)    |
| Net assets released from restrictions used for<br>purchase of property and equipment | 129,888                         | 949,367        |
| Decrease in unrestricted net assets  | (28,071,473)                    | (5,956,958)    |

St. Joseph Health Services of Rhode Island

Statements of Operations and Changes in Net Assets (continued)

|  | Years Ended September 30 |                      |
|--|--------------------------|----------------------|
|  | 2008                     | 2007                 |
| Temporarily restricted net assets:                       |                          |                      |
| Contributions  | \$ 886,627               | \$ 1,060,757         |
| Change in unrealized gains on investments                | 72,967                   | 69,462               |
| Assets released from restriction                         | (411,818)                | (1,130,209)          |
| Increase in temporarily restricted net assets            | 547,776                  | 10                   |
| Permanently restricted net assets:                       |                          |                      |
| Contributions  | 25,200                   | 50,200               |
| Change in unrealized gains on investments                | (1,190,318)              | 898,256              |
| (Decrease) increase in permanently restricted net assets | (1,165,118)              | 948,456              |
| Decrease in net assets                                   | (28,688,815)             | (5,008,492)          |
| Net assets at beginning of year                          | 39,579,360               | 44,587,852           |
| Net assets at end of year                                | <u>\$ 10,890,545</u>     | <u>\$ 39,579,360</u> |

*See accompanying notes.*

# St. Joseph Health Services of Rhode Island

## Statements of Cash Flows

|   | Years Ended September 30 |                |
|---|--------------------------|----------------|
|   | 2008                     | 2007           |
| <b>Operating activities</b>   |                          |                |
| Change in net assets  | \$ (28,688,815)          | \$ (5,008,492) |
| Adjustments to reconcile change in net assets to net cash provided by operating activities: |                          |                |
| Depreciation and amortization   | 6,073,434                | 5,473,206      |
| Restricted contributions  | (911,827)                | (1,110,957)    |
| Net unrealized losses (gains) on investments  | 1,107,865                | (1,036,349)    |
| Adjustment to pension liability   | 18,970,104               | —              |
| Cumulative effect of change in accounting principle for adoption of FAS 158                 | —                        | 4,572,794      |
| Changes in:   |                          |                |
| Patient accounts receivable   | 4,302,887                | (262,873)      |
| Accounts payable  | 1,797,584                | (1,651,093)    |
| Estimated settlements to third-party payors   | (7,155,987)              | (7,977,025)    |
| Other assets and liabilities  | (377,533)                | 4,067,809      |
| Net cash used in operating activities   | (4,882,288)              | (2,932,980)    |
| <b>Investing activities</b>   |                          |                |
| Purchases of property and equipment   | (2,583,805)              | (5,297,298)    |
| Decrease in investments   | 5,023,824                | 10,007,790     |
| (Increase) decrease in assets whose use is limited under bond indenture                     | (6,339)                  | 1,819          |
| Net cash provided by investing activities   | 2,433,680                | 4,712,311      |
| <b>Financing activities</b>   |                          |                |
| Proceeds from long-term debt  | 516,572                  | 425,000        |
| Payments on capital lease obligations   | (1,479,438)              | (1,638,379)    |
| Payments of long-term debt  | (531,427)                | (615,000)      |
| Decrease in pledges receivable  | 74,691                   | 102,503        |
| Restricted contributions  | 911,827                  | 1,110,957      |
| Net cash used in financing activities   | (507,775)                | (614,919)      |
| (Decrease) increase in cash and cash equivalents  | (2,956,383)              | 1,164,412      |
| Cash and cash equivalents at beginning of year  | 8,759,436                | 7,595,024      |
| Cash and cash equivalents at end of year  | \$ 5,803,053             | \$ 8,759,436   |
| <b>Non cash items:</b>  |                          |                |
| Equipment acquired through capital lease  | \$ —                     | \$ 2,660,467   |

See accompanying notes.

# St. Joseph Health Services of Rhode Island

## Notes to Financial Statements

September 30, 2008

### 1. Organization

St. Joseph Health Services of Rhode Island (the Corporation) is an integrated, multilevel, multihospital, healthcare delivery system whose operating divisions serve Rhode Island and Southeastern New England. Core values, as defined by the Corporation's "mission statement," are consistent with the healing ministry of the Catholic Church.

Our Lady of Fatima Hospital in North Providence, a community-based medical center, offers a wide array of inpatient acute-care services, including medical and surgical services, a variety of subspecialties, an emergency department and comprehensive outpatient diagnostic services on-site and at satellite diagnostic centers. It features a regionally recognized critical care pavilion, an ambulatory care center, the state's largest endoscopy center, leading-edge laser technology, hyperbaric medical services and other modern diagnostic services, such as MRI, PET and CT scanner services. Its medical staff has a strong community-based primary care presence, in addition to an extensive selection of specialists.

The St. Joseph Hospital for Specialty Care in Providence offers a wide variety of sophisticated specialty services in addition to the nationally recognized Center for Health and Human Services, an integrated network of primary care and specialty clinics serving the economically disadvantaged and minority populations. Its Center for Psychiatric Services offers comprehensive inpatient adult and geriatric services, in addition to outpatient mental health services on-site and at off-site locations. St. Joseph Hospital for Specialty Care also features the Southern New England Rehabilitation Center, a partnership with Rhode Island Hospital, offering tertiary-level medical rehabilitation for stroke, head and spinal cord trauma, and various other medical conditions. A skilled nursing facility is also operated at St. Joseph Hospital for Specialty Care. Outpatient rehabilitation services are also available through a network of locations. St. Joseph Hospital for Specialty Care is also home to Corporate Care, an occupational health and safety service working with small and large businesses throughout Rhode Island.

In June 2002, Our Lady of Fatima Ancillary Services, a wholly owned subsidiary of the Corporation, entered into a joint venture with MRI Centers of N.E. and opened Northwest Rhode Island Imaging in Johnston, RI. The Corporation's investment in the venture is recognized within long-term investments on an equity basis.

In October 2007, St. Joseph Health Services Foundation, Inc. (the "Foundation") began operations. The Corporation is the sole member of the Foundation. The Foundation has been listed in the Official Catholic Directory and from that derives its 501(c)3 status as an exempt organization whose mission is to raise funds for the specific purpose of supporting the Corporation.

## **St. Joseph Health Services of Rhode Island**

### **Notes to Financial Statements (continued)**

#### **1. Organization (continued)**

The Corporation also operates the St. Joseph School of Nursing and the St. Joseph Living Center. The latter is an assisted-living facility, and serves the emergent needs of the elderly population who desire residential living but require assistance with daily tasks. Respite care services are also provided.

The hospitals are licensed for 386 beds and are fully accredited by the Joint Commission on Accreditation of Hospitals. All operating units have received full licensure and are fully accredited by the numerous various regulating bodies. The hospitals are Medicare certified, participate in the Medicaid program and have contracts with Blue Cross and other health maintenance organization programs currently operating in the market.

#### **2. Significant Accounting Policies**

##### **Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

##### **Cash and Cash Equivalents**

The Corporation considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents, excluding amounts whose use is limited by board designation or other arrangements under trust agreements.

##### **Inventories**

Inventories, consisting primarily of drugs and supplies, are stated at the lower of cost (first-in, first-out) or market.

## **St. Joseph Health Services of Rhode Island**

### **Notes to Financial Statements (continued)**

#### **2. Significant Accounting Policies (continued)**

##### **Deferred Financing Costs**

Deferred financing costs represent the costs associated with the issuance of the 1999 revenue bonds (see Note 8). These costs are being amortized proportionate to the bond maturities. Issuance costs are reported net of accumulated amortization of \$98,512 and \$85,885 at September 30, 2008 and 2007, respectively.

##### **Property, Plant and Equipment**

Property, plant and equipment are recorded at cost. Depreciation is provided on a straight-line basis over the estimated useful life of each class of depreciable assets.

Equipment under capital lease is amortized on the straight-line method over the shorter of the lease term or the estimated useful life of the equipment. This amortization is included in depreciation and amortization expense in the financial statements.

##### **Investments**

Investments in equity and debt securities are reported at fair value in the statements of financial position. Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in the excess of revenues over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments are excluded from the excess of revenues over expenses unless the investments are trading securities. The Corporation accounts for investments in joint ventures and partnerships using the equity method, with the Corporation's share of the earnings (loss) on these ventures and partnerships included in other operating revenue. Distributions from joint ventures, expected to be received within the next year, are classified as current assets.

## **St. Joseph Health Services of Rhode Island**

### **Notes to Financial Statements (continued)**

#### **2. Significant Accounting Policies (continued)**

In accordance with the Hospital's interpretation of the relevant state laws, realized and unrealized gains on endowment and specific purpose funds increase permanently and temporarily restricted net assets, respectively.

##### **Temporarily and Permanently Restricted Net Assets**

Temporarily restricted net assets are those whose use by the Corporation has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by or for the Corporation in perpetuity. Permanently restricted net assets consist primarily of the Corporation's beneficial interest in the Townsend Fund, the income from which is available to support services rendered by the Corporation.

##### **Net Patient Service Revenue**

Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payors and others for services rendered, and includes estimated retroactive revenue adjustments due to future audits and reviews. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits and reviews.

The Healthcare Financing Administration (HCFA) approved a Medicaid disproportionate share plan for the State of Rhode Island. As a result, the Corporation received \$6,447,055 in 2008 and \$7,849,674 in 2007 from Medicaid, which is included in net patient service revenue in the statements of operations and changes in net assets.

##### **Donor-Restricted Gifts**

Unconditional promises to give cash and other assets to the Corporation are reported at fair value at the date the promise is received. Conditional promises to give are reported at fair value at the date the condition is satisfied. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated

## St. Joseph Health Services of Rhode Island

### Notes to Financial Statements (continued)

#### 2. Significant Accounting Policies (continued)

time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statements of operations and changes in net assets as net assets released from restrictions.

#### Deficiency of Revenue over Expenses

The statements of operations and changes in net assets include the deficiency of revenues over expenses. Changes in unrestricted net assets, which are excluded from the deficiency of revenues over expenses, consistent with industry practice, include unrealized gains and losses on investments, changes in the minimum pension liability and contributions of long-lived assets (including assets acquired using contributions, which, by donor restriction, were to be used for the purposes of acquiring such assets).

#### Income Taxes

The Corporation is a not-for-profit hospital as described in section 501(c)(3) of the Internal Revenue Code, and is exempt from federal income taxes on related income pursuant to section 501(a) of the Code.

The Corporation has net operating loss carryforwards of approximately \$2,082,000. A potential deferred tax asset of approximately \$833,000 is offset by a corresponding valuation allowance.

#### Asset Retirement Obligation

Effective September 30, 2006, the Corporation adopted the provisions of Financial Accounting Standards Board Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* ("FIN 47"). Under FIN 47, the Corporation recorded an asset retirement obligation liability related to the estimated future costs of \$2,732,346 to remediate asbestos in certain buildings. Previously, such costs were accounted for as they were incurred. The cumulative effect of adopting this change in accounting principle as of September 30, 2006, represents a decrease in unrestricted net assets of \$2,732,346. During 2008, the Hospital did not have any asbestos abatement costs but did recognize \$156,996 accretion expense. In 2007, the Hospital incurred \$171,180 in asbestos abatement costs and recognized \$156,996 of accretion expense.

## St. Joseph Health Services of Rhode Island

### Notes to Financial Statements (continued)

#### 2. Significant Accounting Policies (continued)

##### New Accounting Standards

On September 29, 2006, the FASB issued Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R)*. The new standard applies to all plan sponsors who offer defined benefit postretirement benefit plans. Statement No. 158 requires an entity to recognize in its balance sheet an asset for a defined benefit postretirement plan's overfunded status or a liability for a plan's underfunded status, measure a defined benefit postretirement plan's assets and obligations that determine its funded status as of the end of the employer's fiscal year, and recognize changes in the funded status of a defined benefit postretirement plan in changes in unrestricted net assets in the year in which the changes occur.

Statement No. 158 does not change the amount of net periodic benefit cost included in the excess of revenue over expenses or address the various measurement issues associated with postretirement benefit plan accounting. The requirement to recognize the funded status of a defined benefit postretirement plan and the disclosure requirements were effective for the year ending September 30, 2007. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for the year ending September 30, 2009.

On October 1, 2007, the Corporation adopted the Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109* (FIN 48). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, and disclosure requirements for uncertain tax positions. The adoption of FIN 48 did not have a material impact on the Corporation's financial statements.

In September 2006, the FASB issued FAS No. 157, *Fair Value Measurements*. FAS 157 defines fair value, establishes a framework for measuring fair value in accordance with accounting principles generally accepted in the United States, and expands disclosure about fair value measurements. FAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Corporation is in the process of determining the effect that the adoption of FAS No. 157 will have on its financial statements.

## St. Joseph Health Services of Rhode Island

### Notes to Financial Statements (continued)

#### 2. Significant Accounting Policies (continued)

In February 2007, the FASB issued FAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. FAS No. 159 permits companies to choose to measure certain financial instruments and other items at fair value that are not currently required to be measured at fair value. FAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Corporation is in the process of determining the effect that the adoption of FAS No. 159 will have on its financial statements.

#### 3. Charity Care and Community Services

The Corporation provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Corporation does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. During 2008 and 2007, the Corporation provided charity care of \$4,994,612 and \$5,791,915, respectively, measured using established rates.

In addition to the above-mentioned medical care rendered, the Corporation provides numerous other services to the community, free of charge. These services include such things as providing access to health care through interpreters, referral and transportation services, health care screening, community support groups, health educational programs, physician services and general community benefit services such as emergency preparedness programs. The cost of services provided to the community with revenues foregone were \$72,273 in 2008 and \$261,680 in 2007.

In addition to the cost of charity care and other community service programs, the Corporation provided \$13,134,259 and \$9,140,373 for uncollectible patient accounts during the years ended September 30, 2008 and 2007, respectively.

# St. Joseph Health Services of Rhode Island

## Notes to Financial Statements (continued)

### 4. Investments

The composition of investments at September 30, 2008 and 2007 is set forth in the following table. Investments are stated at fair value.

|  | 2008                | 2007                |
|--|---------------------|---------------------|
| <i>Assets whose use is limited</i>                   |                     |                     |
| Held by trustee under loan indenture agreements:     |                     |                     |
| Money market funds                                   | \$ 2,657,956        | \$ 2,651,617        |
|  | <u>\$ 2,657,956</u> | <u>\$ 2,651,617</u> |
| Beneficial interest in perpetual trust:              |                     |                     |
| Marketable equity securities                         | \$ 3,250,442        | \$ 4,380,917        |
| Bonds and notes                                      | 1,774,906           | 294,031             |
| Mutual funds   | —                   | 1,675,049           |
| Money market funds                                   | 156,487             | 363,616             |
| Other  | 334,191             | —                   |
|  | <u>\$ 5,516,026</u> | <u>\$ 6,713,613</u> |
| Held by trustee under workers' compensation program: |                     |                     |
| Money market funds                                   | \$ 1,082,530        | \$ 779,905          |
|  | <u>\$ 1,082,530</u> | <u>\$ 779,905</u>   |
| Endowment funds:                                     |                     |                     |
| Money market funds                                   | \$ 24,296           | \$ 458,985          |
| U.S. Treasury obligations                            | 1,144,419           | 663,081             |
|  | <u>\$ 1,168,715</u> | <u>\$ 1,122,066</u> |

St. Joseph Health Services of Rhode Island

Notes to Financial Statements (continued)

4. Investments (continued)

|                              | 2008                | 2007                 |
|------------------------------|---------------------|----------------------|
| <i>Other investments</i>     |                     |                      |
| Current assets:              |                     |                      |
| U.S. Treasury obligations    | \$ 1,217,365        | \$ 789,028           |
| Certificates of deposit      | 800,270             | 806,531              |
| Fixed income mutual funds    | 684,161             | 473,061              |
| Money market funds           | 5,529,177           | 11,425,041           |
|                              | <u>\$ 8,230,973</u> | <u>\$ 13,493,661</u> |
| Long-term investments:       |                     |                      |
| Investment in partnership    | \$ 140,491          | \$ 134,700           |
| Investment in joint ventures | 236,357             | 262,836              |
|                              | <u>\$ 376,848</u>   | <u>\$ 397,536</u>    |

The investment return is comprised of the following for the years ended September 30, 2008 and 2007:

|   | 2008                  | 2007                |
|---|-----------------------|---------------------|
| Included in other operating revenue:                                    |                       |                     |
| Interest income   | \$ 607,170            | \$ 1,002,125        |
| Income from partnership   | 142,040               | 134,442             |
| Loss from joint ventures  | (26,479)              | (11,860)            |
|   | <u>\$ 722,731</u>     | <u>\$ 1,124,707</u> |
| Unrealized investment gains (losses) included in changes in net assets: |                       |                     |
| Unrestricted  | \$ 9,486              | \$ 68,631           |
| Temporarily restricted  | 72,967                | 69,462              |
| Permanently restricted  | (1,190,318)           | 898,256             |
|   | <u>\$ (1,107,865)</u> | <u>\$ 1,036,349</u> |

# St. Joseph Health Services of Rhode Island

## Notes to Financial Statements (continued)

### 5. Property, Plant and Equipment

Property, plant and equipment, by major category, is as follows at September 30:

|  | 2008                 | 2007                 |
|--|----------------------|----------------------|
| Land and improvements                          | \$ 1,657,712         | \$ 1,654,911         |
| Buildings and improvements                     | 63,480,056           | 60,525,782           |
| Furniture and equipment                        | 62,207,172           | 61,050,895           |
| Construction in progress                       | 367,958              | 2,071,967            |
|  | <u>127,712,898</u>   | <u>125,303,555</u>   |
| Less accumulated depreciation and amortization | 82,844,334           | 77,132,821           |
| Property, plant and equipment, net             | <u>\$ 44,868,564</u> | <u>\$ 48,170,734</u> |

### 6. Pledges Receivable

Pledges receivable and the allowances for uncollectible pledges at September 30 are as follows:

|                                   | 2008             | 2007              |
|-----------------------------------|------------------|-------------------|
| Less than one year                | \$ 89,623        | \$ 77,504         |
| One to five years                 | 10,377           | 122,496           |
|                                   | <u>100,000</u>   | <u>200,000</u>    |
| Less unamortized discount         | 5,377            | 25,686            |
|                                   | <u>94,623</u>    | <u>174,314</u>    |
| Less allowance for uncollectibles | 5,000            | 10,000            |
|                                   | <u>\$ 89,623</u> | <u>\$ 164,314</u> |

A discount rate of 6.0% was used for the years ended September 30, 2008 and 2007.

### 7. Line-of-Credit

The Corporation has an agreement with a bank providing for working capital borrowings up to \$4,000,000. These borrowings, which bear interest at the bank's prime rate, are unsecured. No amounts were outstanding under the line-of-credit agreement at September 30, 2008 and 2007.

# St. Joseph Health Services of Rhode Island

## Notes to Financial Statements (continued)

### 8. Long-Term Debt and Capital Leases

Long-term debt consists of the following:

|  | September 30         |                      |
|--|----------------------|----------------------|
|  | 2008                 | 2007                 |
| Obligations under Rhode Island Higher Education Hospital Financing Revenue Bonds, Series 1999, net of original issue discount of \$759,031 and \$776,867 at September, 30 2008 and 2007, respectively; interest rates of 3.50% to 5.50%, due serially to October 1, 2029; interest is payable semiannually at April 1 and October 1 of each year; secured by a pledge of the Corporation's gross receipts and mortgage of certain property | \$ 19,115,969        | \$ 19,558,133        |
| Notes payable  | 870,145              | 425,000              |
| Less current installments  | (578,093)            | (460,000)            |
|  | <u>\$ 19,408,021</u> | <u>\$ 19,523,133</u> |

During 1999, the Corporation issued Rhode Island Health and Educational Building Corporation Hospital Financing Revenue Bonds, Series 1999, in the amount of \$23,145,000. These proceeds were used to refinance all of the Corporation's then-outstanding long-term debt and capital leases of \$9,025,000, and provide \$14,120,000 to be used for capital projects.

The obligations under the Rhode Island Higher Education Hospital Financing Revenue Bonds have specific covenants with which the Corporation must comply. For the year ended September 30, 2008, the Corporation was not in compliance with the required minimum debt service coverage ratio covenant. As required by the trust indenture, the Corporation retained an Independent Consultant to make recommendations regarding rates, fees, charges, management, composition of the Board of the Governing Body or methods of operations to increase the debt service coverage ratio. The report of the Independent Consultant was filed with the Bond Trustee within one hundred and thirty-five days following the fiscal year end as required by the trust indenture. On February 10, 2009, the Corporation received a letter from the Trustee indicating the Corporation had satisfied the requirements of the indenture and remained in compliance with the bond covenants.

# St. Joseph Health Services of Rhode Island

## Notes to Financial Statements (continued)

### 8. Long-Term Debt and Capital Leases (continued)

In addition, the Corporation is required to maintain certain deposits with a trustee. At September 30, 2008 and 2007, such deposits, which are included in assets whose use is limited, are summarized as follows:

|                           | <u>2008</u>         | <u>2007</u>         |
|---------------------------|---------------------|---------------------|
| Debt service fund         | \$ 1,073,374        | \$ 1,024,627        |
| Debt service reserve fund | <u>1,584,582</u>    | <u>1,626,990</u>    |
|                           | <u>\$ 2,657,956</u> | <u>\$ 2,651,617</u> |

Cash paid for interest during 2008 and 2007 amounted to \$1,522,140 and \$1,479,302, respectively.

In 2007, the Corporation entered into a subordinated loan agreement with the Inter-Parish Loan Fund, Inc. in the amount of \$850,000. The loan was to pay for fire code renovations at the St. Joseph Living Center. The ten-year loan payable carries an interest rate of 5% payable in monthly installments of \$9,015 until November 2017. At September 30, 2007, the Hospital received an initial disbursement of \$425,000. The final disbursement of \$425,000 was received on November 15, 2007.

In 2008, the Corporation entered into six individual loan agreements to purchase vehicles previously under operating leases. The term of each agreement is five years and carries interest rates between 8.79% and 11.94%. The cumulative monthly payment of principal and interest for these obligations is \$2,998.

The required annual principal payments of long-term debt at September 30, 2008 for the next five years are as follows:

|      |            |
|------|------------|
| 2008 | \$ 578,093 |
| 2009 | 616,006    |
| 2010 | 628,285    |
| 2011 | 641,397    |
| 2012 | 685,562    |

## St. Joseph Health Services of Rhode Island

### Notes to Financial Statements (continued)

#### 8. Long-Term Debt and Capital Leases (continued)

##### Capital Leases

The Hospital classifies certain noncancelable leases as capital leases and includes the property under lease in its property and equipment along with the related accumulated depreciation.

Future minimum lease payments due under capital lease arrangements at September 30, 2008 are as follows:

|   |                     |
|---|---------------------|
| 2009  | \$ 1,669,336        |
| 2010  | 1,618,511           |
| 2011  | 1,288,580           |
| 2012  | 1,288,580           |
| Total minimum lease payments                | 5,865,007           |
| Less amount representing interest           | 411,004             |
| Present value of net minimum lease payments | <u>\$ 5,454,003</u> |

#### 9. Operating Leases

The Corporation has entered into noncancelable operating lease agreements with several vendors for the lease of certain computer, radiology and other equipment. Total rental expense amounted to \$2,000,876 and \$2,980,143 for the years ended September 30, 2008 and 2007, respectively. Future minimum payments as of September 30, 2008, under noncancelable operating leases, are as follows:

|      |                     |
|------|---------------------|
| 2009 | \$ 978,648          |
| 2010 | 675,436             |
| 2011 | 363,686             |
| 2012 | 177,410             |
| 2013 | —                   |
|      | <u>\$ 2,195,180</u> |

# St. Joseph Health Services of Rhode Island

## Notes to Financial Statements (continued)

### 10. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at September 30, 2008 and 2007:

|                      | 2008                | 2007                |
|----------------------|---------------------|---------------------|
| Capital projects     | \$ 2,145,033        | \$ 1,755,551        |
| Operating activities | 613,381             | 445,219             |
| Educational          | 65,396              | 75,264              |
|                      | <u>\$ 2,823,810</u> | <u>\$ 2,276,034</u> |

Permanently restricted net assets at September 30, 2008 and 2007 are restricted to:

|  | 2008                | 2007                |
|--|---------------------|---------------------|
| Investments to be held in perpetuity, the income from which is available to support health care services | \$ 6,555,470        | \$ 7,720,788        |
| Investments to be held in perpetuity, the income from which is available to support education            | 81,329              | 81,129              |
|  | <u>\$ 6,636,799</u> | <u>\$ 7,801,917</u> |

### 11. Pension Plan

The Corporation's defined benefit pension plan covers substantially all of the Corporation's employees. Plan participants' benefits are computed as a percentage of final average earnings (five highest consecutive rates of annual earnings over the last ten years of employment) less a percentage of Social Security benefits, proportionately reduced for services less than thirty years. Although the plan is not subject to ERISA, the Corporation's intent is to fund \$1,500,000 if financial resources allow. Effective October 1, 2007, the Hospital froze participation in the defined benefit pension plan for all new non-union and Federation of Nurses and Healthcare Professionals ("FNHP") Bargaining Unit employees. In addition, the Hospital also froze participation for all new hires in the United Nurses and Allied Health Professionals ("UNAP") Bargaining Unit October 1, 2008. These new employees will be eligible to participate in a defined contribution plan once certain requirements are met.

## St. Joseph Health Services of Rhode Island

### Notes to Financial Statements (continued)

#### 11. Pension Plan (continued)

##### *Change in Accounting Principle*

In September 2006, the FASB issued SFAS No. 158. The new standard applies to all plan sponsors that offer defined benefit postretirement benefit plans. SFAS No. 158 requires an entity to recognize in its statement of financial position an asset, for a defined benefit postretirement plan's overfunded status, or a liability, for a plan's underfunded status; measure a defined benefit postretirement plan's assets and obligations that determine funded status as of the end of the employer's fiscal year; and recognize the periodic change in the funded status of a defined benefit postretirement plan as a component of changes in unrestricted net assets in the year in which the change occurs.

SFAS No. 158 does not change the amount of net periodic benefit cost recognized or address various measurement issues associated with postretirement benefit plan accounting. Such issues are being reconsidered by the FASB. The requirement to recognize the funded status of its defined benefit pension plan and related disclosure requirements with a corresponding adjustment to other changes in unrestricted net assets was adopted by the Corporation as of September 30, 2007.

The effect of the change in accounting principle upon adoption of SFAS No. 158 represents the net unrecognized actuarial loss and unrecognized prior service cost, both of which previously were netted against the plan's funded status in the Corporation's statements of financial position pursuant to the provisions of SFAS No. 87. These amounts will be subsequently recognized as net periodic pension cost pursuant to the Corporation's historical accounting policy for amortizing such amounts, as indicated in SFAS No. 87. Further, actuarial gains and losses that arise in subsequent periods which are not recognized as net periodic pension cost in the same periods will be recognized as a component of other changes in unrestricted net assets, such amounts will be recognized subsequently as a component of net periodic pension cost through amortization.

The effect of adopting SFAS No. 158 at September 30, 2007, decreased the Corporation's unrestricted net assets by \$4,572,794. The adoption of SFAS No. 158 had no effect on the Corporation's excess of revenues and non-operating gains over expenses for the years ended September 30, 2008 or 2007, and it will not affect the Corporation's operating results in future periods.

# St. Joseph Health Services of Rhode Island

## Notes to Financial Statements (continued)

### 11. Pension Plan (continued)

Included in unrestricted net assets at September 30, 2008 and 2007, respectively, are the following amounts that not yet been recognized in net periodic pension cost: prior service cost of \$3,391,878 and \$3,954,639 and unrecognized actuarial losses of \$20,151,020 and \$618,155. The prior service cost and actuarial loss included in unrestricted net assets and expected to be recognized in net periodic pension cost during the year ending September 30, 2009 are \$562,761 and \$0, respectively

The Corporation, under FAS No. 158 is required to change the measurement date of the pension plan to coincide with the fiscal year end of the Corporation. The estimated decrease in unrestricted net assets is projected to be \$901,944.

The components of the net periodic benefit cost for each of the plans for the years ended September 30, 2008 and 2007 are as follows:

|                                 | 2008                | 2007                |
|---------------------------------|---------------------|---------------------|
| Service cost                    | \$ 3,106,681        | \$ 2,990,452        |
| Interest cost                   | 7,745,979           | 7,326,325           |
| Expected return on plan assets  | (9,840,725)         | (8,778,647)         |
| Prior service cost amortization | 562,761             | 562,761             |
| Amortization of actuarial loss  | —                   | 531,767             |
| Net periodic cost               | <u>\$ 1,574,696</u> | <u>\$ 2,632,658</u> |

The weighted-average assumptions used to determine net periodic benefit cost as of September 30, 2008 and 2007, are as follows:

|  | 2008  | 2007  |
|--|-------|-------|
| Discount rates                                   | 6.25% | 6.25% |
| Rates of increase in future compensation levels  | 3.50% | 3.50% |
| Expected long-term rate of return on plan assets | 8.75% | 8.75% |

# St. Joseph Health Services of Rhode Island

## Notes to Financial Statements (continued)

### 11. Pension Plan (continued)

A reconciliation of the changes in the Corporation's Retirement Plan projected benefit obligations and the fair value of assets for the years ended September 30, 2008 and 2007, and a statement of funded status of the plans as of September 30 for both years, follows:

|  | <u>2008</u>               | <u>2007</u>               |
|--|---------------------------|---------------------------|
| <b>Changes in benefit obligations</b>              |                           |                           |
| Projected benefit obligations at beginning of year | \$ 125,019,624            | \$ 118,012,294            |
| Service cost                                       | 3,106,681                 | 2,990,452                 |
| Interest cost                                      | 7,745,979                 | 7,326,325                 |
| Benefits paid                                      | (4,782,977)               | (4,514,443)               |
| Experience loss                                    | 1,173,547                 | 1,204,996                 |
| Projected benefit obligation at end of year        | <u>132,262,854</u>        | <u>125,019,624</u>        |
| <b>Changes in plan assets</b>                      |                           |                           |
| Fair value of plan assets at beginning of year     | 114,718,822               | 102,323,479               |
| Actual return on plan assets                       | (8,518,593)               | 16,909,786                |
| Employer contributions                             | 1,500,000                 | —                         |
| Benefits paid                                      | (4,782,977)               | (4,514,443)               |
| Fair value of plan assets at end of year           | <u>102,917,252</u>        | <u>114,718,822</u>        |
| <b>Funded status</b>                               |                           |                           |
| Funded status of the plan                          | <u>\$ (29,345,602)</u>    | <u>\$ (10,300,802)</u>    |
| <br>Accumulated benefit obligation                 | <br><u>\$ 107,848,493</u> | <br><u>\$ 100,396,618</u> |

The weighted-average assumptions used to determine the pension benefit obligation at September 30, 2008 and 2007 are as follows:

|  | <u>2008</u>   | <u>2007</u>   |
|--|---------------|---------------|
| Discount rates                                   | 6.25%         | 6.25%         |
| Rates of increase in future compensation levels  | 3.50%         | 3.50%         |
| Expected long-term rate of return on plan assets | 8.75%         | 8.75%         |
| Measurement date                                 | June 30, 2008 | June 30, 2007 |

## St. Joseph Health Services of Rhode Island

### Notes to Financial Statements (continued)

#### 11. Pension Plan (continued)

##### Plan Assets

The primary investment objective of the Corporation's defined benefit pension plan is to provide pension benefits for its members and their beneficiaries by ensuring a sufficient pool of assets to meet the Plan's current and future benefit obligations. These funds are managed as permanent funds with disciplined longer-term investment objectives and strategies designed to meet cash flow requirements of the plan.

Management of the assets is designed to maximize total return while preserving the capital values of the fund, protecting the fund from inflation, and provide liquidity as needed for plan benefits. The objective is to provide a rate of return that meets inflation, plus 5.0%, over a long-term horizon.

The plan aims to diversify its holdings among sectors, industries and companies.

A periodic review is performed of the pension plan's investment in various asset classes. The current asset allocation target is 70% equities and 30% fixed income.

The Corporation's pension plan asset allocations at September 30, 2008 and 2007, by asset category are as follows:

|   | Plan Assets at September 30 |      |
|---|-----------------------------|------|
|   | 2008                        | 2007 |
| Marketable equity securities                    | 70%                         | 75%  |
| U.S. government obligations and corporate bonds | 28                          | 23   |
| Other   | 2                           | 2    |
| Total   | 100%                        | 100% |

## St. Joseph Health Services of Rhode Island

### Notes to Financial Statements (continued)

#### 11. Pension Plan (continued)

##### Estimated Future Benefit Payments

Benefit payments, which reflect expected future service, are expected to be as follows:

| <u>Fiscal Year</u> | <u>Pension<br/>Benefits</u> |
|--------------------|-----------------------------|
| 2009               | \$ 4,465,000                |
| 2010               | 4,762,000                   |
| 2011               | 5,075,000                   |
| 2012               | 5,546,000                   |
| 2013               | 5,941,000                   |
| Years 2014–2017    | 38,985,000                  |

#### 12. Professional Liability Insurance

The Corporation insures its professional liability risks pertaining to medical malpractice on a claims-made basis. From October 1, 1998 to October 1, 2001, the Corporation was insured for professional liability loss contingencies by an insurance company that, on August 16, 2001, was placed into rehabilitation by the insurance commissioner of the Commonwealth of Pennsylvania. The Corporation has established reserves to cover professional liability exposure that may not be covered by current or prior insurance policies, including a reserve for estimated claims incurred but not reported to the insurance company.

#### 13. Workers' Compensation

As of December 1, 1999, the Corporation obtained commercial insurance for its workers' compensation liability. The Corporation maintains a stop-loss insurance policy for workers' compensation claims made prior to December 1, 1999. Accordingly, amounts up to the stop-loss limit are self-insured by the Corporation. The Corporation has accrued its estimate of the ultimate potential workers' compensation loss based upon an actuarial study, which developed the estimated loss based upon actual paid claims. The estimated ultimate losses were discounted using a rate of five percent. In order to provide for the ultimate payment of the estimated loss, the Corporation has deposited amounts into a trust that are sufficient to fund the estimated liability. In addition, the Corporation has posted a \$650,000 surety bond.

## St. Joseph Health Services of Rhode Island

### Notes to Financial Statements (continued)

#### 14. Third-Party Payment Arrangements

The Corporation maintains agreements with the Social Security Administration under the Medicare program, the State of Rhode Island under the Medicaid Program, Blue Cross of Rhode Island and United Health Plans of New England, among others, that govern payment to the Corporation for services rendered to patients covered by these programs.

Medicare utilizes a prospective payment system for inpatient medical surgical, rehabilitation and transitional care services where payment is based on the classification of a case into a diagnosis-related group (DRG). Inpatient psychiatric nonacute services related to Medicare beneficiaries are paid based on cost up to a specified limit. Medicare outpatient services are paid on a prospective payment system based upon ambulatory payment classifications (APC). The method of payment for Rhode Island Blue Cross is a per diem system for inpatient services and a negotiated fee schedule for outpatient services.

The majority of Rhode Island Medicaid patients are reimbursed under the RiteCare program funded by the State of Rhode Island. The RiteCare program is administered by area insurance companies and HMOs. Most of the Corporation's revenue from the RiteCare program is through United Health Plans of New England and Neighborhood Health Plan and payments are based upon per diems for inpatients and fee schedules for outpatient services. Medicaid patients not included in the RiteCare program are reimbursed based on budgeted costs under a prospective cost contract and reimbursement is adjusted based upon actual patient volume.

The Corporation has entered into contracts with other insurance companies and health maintenance organizations whereby they are generally paid on a per-diem or case rate (DRG) basis for inpatients and fee schedules for outpatient services.

Cost reports filed annually with third-party payors are subject to audit prior to final settlement. The Corporation has settled with Medicaid through 2006, and with Medicare through 2005.

## St. Joseph Health Services of Rhode Island

### Notes to Financial Statements (continued)

#### **14. Third-Party Payment Arrangements (continued)**

Revenues from the Medicare and Medicaid programs accounted for approximately 33% and 7%, respectively, of the Corporation's gross patient revenue for the years ended September 30, 2008 and 2007. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. The Corporation believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation. There is at least a reasonable possibility that recorded amounts could change by a material amount in the near term. Differences between amounts previously estimated and amounts subsequently determined to be recoverable or payable are included in net patient service revenues in the year that such amounts become known. Such differences increased revenues by approximately \$925,567 and \$2,946,000 for the years ended September 30, 2008 and 2007, respectively.

During fiscal 2008 and 2007, hospitals in Rhode Island were subject to a state license fee based on a percentage of gross charges, which is reflected as an expense in the statement of operations. The license fee was \$5,259,352 and \$4,919,485 for the years ended September 30, 2008 and 2007.

#### **15. Concentrations of Credit Risk**

The Corporation grants credit to patients, substantially all of whom are local residents. The Corporation generally does not require collateral or other security in extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients benefits payable under their health insurance programs, plans or policies (e.g., Medicare, Medicaid, Blue Cross, health maintenance organizations and commercial insurance policies).

## St. Joseph Health Services of Rhode Island

### Notes to Financial Statements (continued)

#### 15. Concentrations of Credit Risk (continued)

The mix of receivables from patients and third-party payors at September 30, 2008 and 2007:

|                                  | 2008 | 2007 |
|----------------------------------|------|------|
| Medicare                         | 29%  | 27%  |
| Blue Cross                       | 14   | 19   |
| Medicaid                         | 6    | 11   |
| Health maintenance organizations | 31   | 25   |
| Commercial                       | 3    | 5    |
| Workers' compensation            | 1    | 1    |
| Self-pay                         | 16   | 12   |
|                                  | 100% | 100% |

#### 16. Affiliation

The Corporation has entered into a memorandum of understanding with Roger Williams Medical Center to affiliate. Under the proposed affiliation, each hospital will operate under their current license while all administrative, strategic planning, financial operations and capital control will be managed by a parent corporation. Both organizations plan on filing the affiliation Hospital Conversion Act application in early 2009.